

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 01-0040
Use Tax—Employee Purchases
Gross Retail and Use Tax—Duplicate Assessments
Use Tax—Inventory Items
Tax Administration—Penalty
For Tax Years 1997-1999

NOTICE: Under Ind. Code § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Use Tax—Employee Purchases

<u>Authority:</u>	IC § 6-2.5-2-1	
	IC § 6-2.5-3-1	45 IAC 2.2-2-1
	IC § 6-2.5-3-2	45 IAC 2.2-2-2
	IC § 6-2.5-3-4	45 IAC 2.2-3-4
	IC § 6-2.5-4-1	45 IAC 2.2-3-14
	IC § 6-2.5-6-7	45 IAC 2.2-3-18
	IC § 6-2.5-9-3	45 IAC 2.2-3-19
	IC § 6-8.1-5-1	

Taxpayer protests the proposed assessment of Indiana's use tax on employee purchases, arguing that the employees are liable for the tax.

II. Gross Retail and Use Tax—Duplicate Assessments

Taxpayer protests the proposed assessments of Indiana's gross retail and use taxes, arguing that some of the assessments are duplicates.

III. Use Tax—Items Held in Inventory

Authority:	IC § 6-2.5-3-1
	IC § 6-2.5-3-2

Taxpayer protests the proposed assessment of Indiana's use tax on manufactured items held in inventory before being sold or used.

IV. Tax Administration—Penalty

Authority: IC § 6-8.1-10-2.1

45 IAC 15-11-2

Taxpayer protests the proposed assessment of the negligence penalty.

STATEMENT OF FACTS

Taxpayer is a pipeline contractor engaged in the installation, trenchless rehabilitation, lining, replacement and upgrading of gas mains and/or deteriorating pipelines carrying water, wastewater, or natural gas. Taxpayer performs some time/material contracts where the state's gross retail tax is properly collected and remitted to the Department. The majority of taxpayer's work is for labor only. According to the audit, "[t]he taxpayer consistently indicates on purchase invoices when materials, tools, equipment, or supplies are purchased for resale or used/consumed in the performance of [taxpayer's] construction contracts 'by stating **resale** on the actual purchase invoice, use tax accrual on sales reports, and/or placing the item in a taxable general ledger account or in inventory.'" However, there were a number of items purchased without sales tax being paid; therefore, the audit assessed use tax on those items, and assessed a 10% negligence penalty. Taxpayer paid the assessments, but only after subtracting figures taxpayer alleged represented duplicate assessments. The protest was forwarded to the Legal Division for resolution by way of a protest hearing. Taxpayer's representative sent documents in advance of the telephone conference hearing. Further facts will be added as necessary.

I. Use Tax—Employee Purchases

DISCUSSION

Taxpayer protests the proposed assessments of Indiana's use tax based on the best information available to the Department at the time of the audit. Because of taxpayer's and his representative's inability to timely provide the proper documents to the auditor, a hearing was set before one of the Legal Division's Hearing Officers. Taxpayer's representative provided sufficient documentation, and explanations of how differing accounts worked in taxpayer's accounting methods, that the Department can now determine taxpayer's proper tax liability. Taxpayer has also withdrawn part of the use tax protest, acknowledging that additional use tax is owed.

Under IC § 6-8.1-5-1(b), a "notice of proposed assessment is *prima facie* evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." IC § 6-2.5-2-1 imposes the tax retail merchants are required to collect and remit:

- (a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.
- (b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail

merchant as a separate added amount to the consideration in the transaction. **The retail merchant shall collect the tax as agent for the state.**

(Emphasis added). *See also*, 45 IAC 2.2-2-1 and 45 IAC 2.2-2-2.

IC § 6-2.5-3-1 defines “use,” for purposes of Indiana’s use tax statute and regulations, as the “exercise of any right or power of ownership over tangible personal property. IC § 6-2.5-3-2 imposes the use tax:

- (a) An excise tax, known as the use tax, is imposed on the storage, use or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

See also, 45 IAC 2.2-3-4.

Storage, use, and consumption of tangible personal property in Indiana is exempt from the use tax if “(1) the property was acquired in a retail transaction in Indiana and the state gross retail tax has been paid on the acquisition of that property.” IC § 6-2.5-3-4; 45 IAC 2.2-3-14. Taxpayers who use, store, or consume tangible personal property acquired in a retail transaction are “personally liable for the use tax.” *See also*, 45 IAC 2.2-3-18 and 45 IAC 2.2-3-19.

One of the areas where the Audit Division assessed use tax owed to the Department concerns an account taxpayer has set up to handle employee purchases of items taxpayer obtains from its vendors and offers as a benefit to its employees. If taxpayer is acting as a retail merchant in these kinds of transactions, then taxpayer should have collected and remitted retail tax.

Taxpayer argued at the hearing that if any retail tax was owed, the employees purchasing these items owed the tax. Taxpayer is correct. However, taxpayer should have collected and remitted the tax pursuant to IC § 6-2.5-2-1(b). Since taxpayer did not collect and remit the gross retail tax, and since taxpayer cannot prove the items at issue were purchased for resale, taxpayer is liable for use tax under IC § 6-2.5-3-1, IC § 6-2.5-3-2, IC § 6-2.5-6-7 and IC § 6-2.5-9-3.

Two areas where the Audit Division assessed Indiana’s use tax involve a mistake on taxpayer’s part where taxpayer mistakenly placed helmets taxpayer uses into a nontaxable inventory account rather than into the proper, use taxable account. Taxpayer has withdrawn that part of its protest over the following use tax assessments:

1997:	\$313.69
1998:	\$647.82
1999:	\$1,133.62

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Taxpayer's protest concerning the proposed assessment of use tax on employee purchases is denied.

II. Gross Retail and Use Tax—Duplicate Assessments

The second issue concerns one of taxpayer's capital accounts. Taxpayer presented sufficient evidence to show that the projection method the auditor relied on was unnecessary in that all invoices for the tax years at issue were examined. Moreover, neither taxpayer, nor an authorized representative signed the Agreement to the Projection Method. Such a signature would have bound taxpayer to the projection method. Several items were taxed twice, once as a purchase, once as a capital asset. These doubly taxed items should have only been taxed once. They include two items purchased at auction. Page 33 of the Audit Summary shows the items taxed as capital assets. Both items also show up on page 15 as purchases. *See*, yellow highlighted areas in taxpayer's materials faxed in advance of the hearing, tabs labeled A and B.

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Taxpayer's protest concerning duplicate assessments is sustained.

III. Use Tax—Items Held in Inventory

The third issue concerns another one of taxpayer's capital accounts. Taxpayer makes tangible personal property in its fabrication shop, such as special equipment, trucks, engines, etc. For example, at any given time, taxpayer may make three pieces of equipment at a time, producing one or two for resale, its own use, or just to exist until a decision is made concerning what to do with it. If taxpayer decides to capitalize it, taxpayer pays use tax; if taxpayer decides to sell it, taxpayer collects and remits gross retail tax. However, use tax is also owed for the time items are stored before taxpayer decides what to do with them. *See*, IC § 6-2.5-3(1)(a) and (b); IC § 6-2.5-3-2 (a).

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Taxpayer's protest concerning the proposed assessments of use tax on items held in inventory is denied.

IV, Tax Administration—Penalty

DISCUSSION

Taxpayer protests the imposition of the 10% negligence penalty. Taxpayer argues that it had reasonable cause for failing to pay the appropriate amount of tax due, based solely on taxpayer's review of its records compared to the figures in the Audit Summary.

Indiana Code Section 6-8.1-10-2.1(d) states that if a taxpayer subject to the negligence penalty imposed under this section can show that the failure to file a return, pay the full amount of tax

shown on the person's return, timely remit taxes held in trust, or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty. Indiana Administrative Code, Title 45, Rule 15, section 11-2 defines negligence as the failure to use reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence results from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by Indiana's tax statutes and administrative regulations.

In order for the Department to waive the negligence penalty, taxpayer must prove that its failure to pay the full amount of tax due was due to reasonable cause. Taxpayer may establish reasonable cause by "demonstrat[ing] that it exercised ordinary business care and prudence in carrying or failing to carry out a duty giving rise to the penalty imposed. . . ." In determining whether reasonable cause existed, the Department may consider the nature of the tax involved, previous judicial precedents, previous department instructions, and previous audits.

Taxpayer has not set forth a basis whereby the Department could conclude taxpayer exercised the degree of care statutorily imposed upon an ordinarily reasonable taxpayer. Some of the questions raised by taxpayer involved technical issues of interpretation and applicability, such as the capital accounts and double taxation of items. However, taxpayer was negligent in not properly assessing and remitting all use tax owed to the Department.

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Taxpayer's protest concerning the proposed assessment of the 10% negligence penalty is denied.